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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, *ex rel.*
SCOTT ROSE, MARY AQUINO,
MITCHELL NELSON and LUCY
STEARNS,

Plaintiffs,

vs.

STEPHENS INSTITUTE, a California
corporation, doing business as ACADEMY
OF ART UNIVERSITY and DOES 1 through
50, Inclusive,

Defendants.

Case No. C-09-5966-PJH

**SECOND AMENDED COMPLAINT
FOR DAMAGES, AND DEMAND FOR
JURY TRIAL**

Claims:

1. Knowingly Presenting, or Causing to Be Presented, a False or Fraudulent Claim for Payment or Approval, 31 U.S.C. § 3729(a)(1)(A).
2. Knowingly Making, Using, or Causing to Be Made or Used, a False Record or Statement Material to a False or Fraudulent Claim, 31 U.S.C. § 3729(a)(1)(B).

1 Plaintiffs and Relators SCOTT ROSE, MARY AQUINO, MITCHELL NELSON and LUCY
2 STEARNS allege as follows:

3 **PRELIMINARY ALLEGATIONS**

4 1. This is an action to recover damages and civil penalties on behalf of the United
5 States of America arising out of false claims presented by defendant Stephens Institute doing
6 business as Academy of Art University (“AAU”).

7 2. From at least the Fall of 2003, continually, through the present, AAU obtained
8 millions of dollars annually from the United States Department of Education (“DOE”) pursuant
9 to the Higher Education Act, Title IV (“HEA”).

10 3. As a condition of receiving such funds, AAU represented to the DOE that it was
11 in compliance with the HEA’s prohibition against incentive based compensation for recruiters.

12 4. In fact, at all relevant times herein, AAU was not in compliance with the HEA’s
13 incentive compensation ban and its representations of compliance to the DOE were and are false.

14 5. AAU had and continues to have actual knowledge that they are not in
15 compliance with the HEA’s ban, that its representations of compliance were and are false and
16 that it was therefore submitting false or fraudulent representations of compliance.

17 6. Alternatively, Defendants acted with deliberate indifference and/or reckless
18 disregard as to the truth or falsity of the claims.

19 7. Relators assert causes of action/claims under the False Claims Act for
20 submission of a knowingly false or fraudulent claim for payment or approval, and knowingly
21 presenting false records or statements to get a false or fraudulent claim paid or approved, in
22 violation of 31 U.S.C. § 3729(a)(1) and (2).

23 **JURISDICTION AND VENUE**

24 8. This action is brought pursuant to the False Claims Act, 31 U.S.C. §§ 3729, *et*
25 *seq.* Subject matter jurisdiction is invoked pursuant to 28 U.S.C. § 1331. This case arises from
26 the wrongful conduct of the Defendants incident to obtaining funds from the United States of
27 Department of Education pursuant to the Higher Education Act, Title IV.

28 9. This Court has *in personam* jurisdiction over the Defendants under 31 U.S.C. §

1 3732(a).

2 10. Venue is proper in the Northern District of California because Defendants
3 maintain and operate their campus within this District.

4 11. 31 U.S.C. § 3732(a) provides, “Any action under 3730 may be brought in any
5 judicial district in which the defendant or, in the case of multiple defendants, any one defendant,
6 can be found, resides, transacts business, or in which any act proscribed by section 3729
7 occurred.”

8 **PLAINTIFFS**

9 12. *Qui Tam* plaintiffs-relators SEAN ROSE, MARY AQUINO, MITCHELL
10 NELSON, and LUCY STEARNS are citizens of the United States of America and are residents
11 of the Northern District of California. Plaintiff-relators bring this action on behalf of the United
12 States of America.

13 13. Relators, simultaneously with the filing of this Complaint, provided to the United
14 States Attorney for the Northern District of California a statement of all material evidence and
15 information related to this Complaint as required under the False Claims Act, 31 U.S.C. §
16 3730(b)(2).

17 14. The United States of America is named a plaintiff in this action because funds of
18 the United States of America were fraudulently obtained by defendant AAU.

19 **DEFENDANTS**

20 15. Defendant AAU is a private, for-profit higher education institution, which
21 maintains multiple academic and housing facilities in San Francisco, California. AAU claims to
22 be the largest private school of art and design in the United States and that it is accredited by the
23 Western Association of Schools and Colleges (“WASC”).

24 16. Relators are unaware of the true names and capacities of the Defendants sued as
25 Does 1 through 50. Plaintiffs will amend their complaint when their true names and capacities
26 have been ascertained. Each Doe Defendant is responsible in some actionable manner for the
27 events, occurrences, injuries and damages alleged herein.

28 17. The term “defendants” refers collectively to the aforesaid defendants acting by

1 and through their managerial employees, and each of them.

2 18. In doing the acts and things described in this complaint, managerial employees of
3 the defendants acted within the course and scope of their respective agencies and/or employment
4 with the defendants, and each of them, with the knowledge and consent of the defendants, and
5 each of them.

6 19. In doing the acts and things described in this complaint each defendant was the
7 authorized agent of each other defendant.

8 **SPECIFIC FALSE CLAIMS AND FRAUDULENT STATEMENTS**

9 **I. THE FRAUDULENT INCENTIVE COMPENSATION SCHEME**

10 20. 20 U.S.C. §1094 prohibits colleges and universities that receive federal funds
11 from providing “any commission, bonus, or other incentive payment based directly or indirectly
12 on success in securing enrollments or financial aid to any persons or entities engaged in any
13 student recruiting or admission activities....” This law is intended to prevent and avoid the risk
14 that recruiters will enroll poorly qualified students who will derive little benefit from federally-
15 funded tuition and other subsidies and may be unable or unwilling to repay federally guaranteed
16 loans.

17 21. During the relevant period, DOE regulations contained a so-called “Safe Harbor”
18 provision, which provided that an educational institution may, without violating the ban on
19 incentive-based compensation, provide “payment of fixed compensation, such as a fixed annual
20 salary or a fixed hourly wage, as long as that compensation is not adjusted up or down more than
21 twice during any twelve month period and any adjustment is not based solely on the number of
22 students recruited, admitted, enrolled, or awarded financial aid.” 34 C.F.R. §
23 668.14(b)(22)(ii)(A) (2010).

24 22. At all material times herein, AAU violated the foregoing Title IV prohibition by
25 adjusting the compensation of admissions representatives, including (but not limited to) the
26 plaintiff-relators herein, in a manner based solely, directly and indirectly on their success in
27 securing enrollments or financial aid, and knew that it was violating the Title IV prohibition.

28

1 23. At all material times herein, AAU’s method of determining the compensation of
2 admissions representatives failed to fall within the foregoing so-called “Safe Harbor” provision.
3 AAU knew it failed to meet the Safe Harbor requirements and/or acted in reckless disregard of
4 that fact because, in fact and in practice, adjustments to recruiter compensation were based
5 solely on the basis of the number of students recruited, admitted enrolled or awarded financial
6 aid.

7 24. During the relevant period, admissions representatives including (but not limited
8 to) the plaintiff-relators herein, were given an enrollment “goal” at the start of each recruiting
9 period. Admissions representatives were strongly encouraged and pressured to meet those
10 enrollment or registration goals.

11 25. Based solely on whether or not they met or exceeded this enrollment goal, the
12 compensation of admission representatives including (but not limited to) the plaintiff-relators
13 herein, was increased *or decreased* twice a year, in March and October.

14 26. For example, in or about July 2010, plaintiff-relator Mary Aquino was informed
15 by Noreen Chan, Admissions Manager, that she would receive an \$8,000 salary increase if she
16 met her recruitment goal of 65 students, if she achieved 125% of that goal she would receive a
17 \$10,000 salary increase and if she achieved 150% of that goal, she would receive \$15,000 salary
18 increase. *See* Exhibit A (email exchange); Exhibit B (note in handwriting of Noreen Chan).

19 27. In or about June 2009, Admissions Representative Thai Lam spoke with Rachel
20 Lee AAU’s Chief Operating Officer. Lee explained that all increases and decreases to
21 admissions representatives were based on meeting or exceeding recruitment numbers, *i.e.*, if the
22 representative met their goal, he or she would receive a salary increase of \$8,000 and if he or she
23 failed to meet their goal their annual salary would be *decreased* by \$8,000. Exhibit C [June 12,
24 2009 email from Thai Lam].

25 28. AAU attempted to conceal its fraudulent compensation scheme and unlawful
26 conduct by refusing to write down or share documents containing the recruitment goals and
27 corresponding compensation adjustments and by refusing to disclose to and refusing to allow its
28 admissions representatives to retain any written documentation of its incentive compensation

1 scheme.

2 29. In or about December 2009, Veronica Del Rico, Director of Admissions, refused
3 to provide plaintiff-relator Mitch Nelson with a document that reflected his admissions goals and
4 the amount his compensation was being reduced as a direct result of, and in proportion to, the
5 amount by which he failed to meet that goal. Exhibit D [email between M.Nelson and V. Del
6 Rico, December 16-17, 2009]. Instead, AAU conveyed the enrollment goals and accompanying
7 financial incentives only through information sheets that were shown to admissions
8 representatives at their semiannual evaluations but were retained by AAU.

9 30. In or about MID-2011, Admissions Representative Scott Rose manually copied
10 *verbatim* information from a document Veronica del Rico, AAU's Vice President of Training
11 and Development, had shown but refused to provide to with Mr. Rose. That document indicated
12 if the admissions representatives met their recruitment goals, they would receive a salary
13 increase of \$8,000; if they met 125% of their goal, they would receive a salary increase of
14 \$10,000 and if they met 150% of their goal they would receive a salary increase of \$15,000.
15 Exhibit E.

16 31. Admissions representatives could also have their compensation reduced or clawed
17 back based directly on their success in meeting numerical enrollment goals. Twice a year,
18 admissions representatives would receive an "Overpayment Adjustment Form" in which they
19 were informed of how much of the compensation was being clawed back if they had failed to
20 meet their recruitment goals. These "Overpayment Adjustment Forms" identified from which of
21 their future paychecks money would be withheld and by how much each paycheck would be
22 reduced. Exhibit F. AAU's determination on whether to reduce or claw back salary from
23 admissions representatives on account of their failure to meet predetermined registration goal
24 was made solely based upon the number of students the admissions representatives had recruited
25 (or failed to recruit) in relation to each admission representative's predetermined registration
26 goal. No other criteria were used in this calculation. (Exhibit F)

27 32. Admissions representatives were told by AAU that, if they met their enrollment
28 "goal," (in reality, a quota), their annual salary could be increased by as much as \$30,000 at the

1 time of their next evaluation. If the admissions representatives then met their registration and
2 enrollment goals, AAU increased their salary by \$30,000 at the time of their next review.

3 33. Plaintiff-relators' salary histories illustrate and substantiate the unlawful
4 compensation scheme alleged herein.

5 34. In addition to salary, AAU also illegally compensated enrollment counselors
6 based upon enrollments through trips and gifts. Enrollment counselors were promised a trip to
7 Hawaii if their team enrolled a minimum number of students.

8 35. AAU attempted to conceal its fraud and violations of 20 U.S.C. § 1094 from the
9 United States and others, and to continue to receive federal funding under false and fraudulent
10 pretenses, by creating sham and superficial "qualitative criteria" by which it purported to
11 measure the job performance of its admissions representatives and upon which to base their
12 individual compensation. In fact, these criteria were based on basic requirements that any
13 employee would be required to meet, and in fact and in practice had no impact on increases or
14 decreases to the compensation of admissions representatives, which increases and decreases
15 were, in truth and in practice, based solely upon whether the admissions representatives met their
16 enrollment or registration goals. AAU never intended to use nor did it ever use the pretextual
17 qualitative criteria to determine the total compensation of its admissions representatives, but
18 instead continued to use student recruitment and enrollment data as the sole criteria to determine
19 increases and decreases to the compensation of its admissions representatives.

20 36. At all times mentioned herein, AAU was and is fully aware of the illegality of the
21 compensation plan, structure and scheme under which it was compensating its admissions
22 representatives.

23 **II. AAU'S FALSE CERTIFICATIONS OF COMPLIANCE TO THE FEDERAL**
24 **GOVERNMENT**

25 37. Educational institutions request Title IV funds for eligible students through
26 several programs, including the federally funded Pell Grant Program ("Pell"), the Federal
27 Supplemental Educational Opportunity Grant Program ("FSEOG"), the Federal Perkins Loan
28 Program ("Perkins") and the Federal Family Education Loan Program ("FFELP").

1 38. AAU's eligibility to receive these funds is explicitly conditioned on its
2 compliance with the incentive compensation ban in at least three separate respects.

3 39. First, in order to be eligible to receive Title IV funds, educational institutions are
4 required to enter into a Program Participation Agreement with the United States Government,
5 which prohibits incentive compensation. AAU entered a Program Participation Agreement with
6 the United States Government that states:

7 The execution of this Agreement [which contains a reference to the incentive
8 compensation ban] by the Institution and the Secretary is a prerequisite to the
9 Institution's initial or continued participation in any Title IV, HEA Program.

10 40. Second, 20 U.S.C. § 1094(a) states that in order to be eligible to receive Title IV
11 funds, an institution must:

12 [E]nter into a program participation agreement with the Secretary [of Education].
13 The agreement ***shall*** condition the initial and continuing eligibility of an
14 institution to participate in a program upon compliance with the following
15 requirements ... [including the incentive compensation ban.] 20 U.S.C. § 1094(a)
16 [emphasis added].

17 41. Third, 34 C.F.R. § 668.14(a)(1) states:

18 An institution may participate in any Title IV, HEA program ... only if the
19 institution enters into a written program participation agreement with the
20 Secretary.... A program participation agreement conditions the initial and
21 continued participation of an eligible institution in any Title IV, HEA program
22 upon compliance with the provisions of this part [such as the incentive
23 compensation ban.]” 34 C.F.R. § 668.14(a)(1).

24 42. Compliance with the ban prohibiting incentive compensation is thus a necessary
25 condition of eligibility to receive Title IV funds.

26 43. By falsely representing its compliance with the incentive compensation ban in the
27 Agreement, AAU made knowingly false statements which have resulted in the Department of
28 Education paying millions of dollars to AAU which it was not entitled to lawfully receive.

III. AAU'S CLAIMS FOR FEDERAL GOVERNMENT FUNDS

44. Upon entering the Program Participation Agreement with the United States Secretary of Education, AAU became eligible to request the Title IV funds from the United States Secretary of Education (for Pell Grant funds) or from third party lenders (for government-insured loans).

45. To obtain Pell Grant funds, AAU submits a request for those funds directly to the Secretary of the United States Department of Education. The request for funds is not a student application but rather a request prepared and transmitted by AAU to the Secretary of the United States Department of Education, stating the requested amount of funds. The United States Department of Education transfers the Pell Grant funds electronically directly into a AAU account. Upon receiving the Pell Grant funds, AAU credits various AAU students for tuition paid.

46. AAU's claims for the Pell Grant funds are fraudulent. When AAU requests, receives and retains Pell Grant funds, AAU knows it is not eligible to lawfully receive those funds because of its intentional violations of the Higher Education Act incentive compensation ban as alleged hereinabove.

47. To obtain government-insured loans for enrolling students, including the FFELP, AAU submits the request for those funds directly to a private lender. The lender then transfers the government-insured loan funds directly into a AAU bank account. Upon receiving the government-insured loan funds, AAU credits various AAU students for tuition paid.

48. AAU's violations of the HEA incentive compensation ban make it an ineligible educational institution to request and disburse Title IV funds and thus its students are ineligible under the Title IV program.

49. AAU's claims for federal government-insured loan funds are fraudulent. When AAU requests, receives and retains the government-insured loan funds, AAU knows it is ineligible for those funds because of its intentional violations of the Higher Education Act incentive compensation ban. AAU knows that compliance with the Higher Education Act funding statute incentive compensation restriction is a core prerequisite for an institution's

1 eligibility to request and receive Title IV funds.

2 50. The United States Government pays all interest on the government-insured loans
3 while the students are enrolled in classes and during authorized grace periods. The loans are
4 guaranteed by state agencies and/or non-profit organizations ("guarantee agencies"), and are
5 subsidized and reinsured by the United States Department of Education. If a student defaults, the
6 guarantee agency reimburses the lender. If the guarantee agency cannot collect from the student,
7 the Department of Education reimburses the agency.

8 51. The United States Department of Education monitors loan defaults of
9 postsecondary schools and calculates a "cohort default rate" every year for AAU. The
10 Department of Education calculates the loss to the United States Government relying upon this
11 rate.

12 **FIRST CLAIM**

13 **Knowingly Presenting, or Causing to Be Presented, a False or Fraudulent** 14 **Claim for Payment or Approval, 31 U.S.C. § 3729(a)(1)(A).**

15 52. Plaintiffs re-allege, and fully incorporate herein by reference, paragraphs 1
16 through 51 herein.

17 53. In performing all of the acts set out herein, defendants knowingly presented, or
18 caused to be presented, multiple false and/or fraudulent claims to the United States Department
19 of Education for its payment or approval, in violation of the False Claims Act (31 U.S.C. §
20 3729(a)(1)(A), to the damage of the Treasury of the United States of America, causing the
21 United States to pay out millions of dollars to AAU it was not obligated to pay.

22 **SECOND CLAIM**

23 **Knowingly Making, Using, or Causing to Be Made or Used, a False Record or** 24 **Statement Material to a False or Fraudulent Claim, 31 U.S.C. § 3729(a)(1)(B).**

25 54. Plaintiff-relators re-allege, and fully incorporate herein by reference, paragraphs 1
26 through 53 herein.

27 55. By virtue of the acts described above, AAU has knowingly made, used or caused
28 to be made or used, false records or statement material to a false or fraudulent claim, in

1 contravention of the False Claims Act (31 U.S.C. §3729(a)(1)(B)), to the damage of the Treasury
2 of the United States of America, by causing it to pay out millions of dollars to AAU it was not
3 obligated to pay.

4 **PRAYER FOR RELIEF**

5 WHEREFORE, Plaintiffs request the following relief:

- 6 1. Judgment in favor of the United States of America against defendants, jointly and
7 severally, by reason of the violations of the False Claims Act as set forth above, in an
8 amount equal to three times the amount of damages the United States has sustained
9 because of defendants' actions, plus a civil penalty of not less than Five Thousand
10 Dollars (\$5,000), and not more than Ten Thousand Dollars (\$10,000.00), for each
11 violation;
- 12 2. Award to plaintiff-relators, as *Qui Tam* plaintiffs, of the maximum amount allowed
13 pursuant to 31 U.S.C. § 3730(d) of the False Claims Act on the United States' Recovery;
- 14 3. Award to plaintiff-relators of all reasonable expenses which the Court finds to have been
15 necessarily incurred, plus reasonable attorneys' fees and costs;
- 16 4. Punitive damages on all causes of action, to the extent allowable by law; and
- 17 5. Such other and further relief as the Court deems proper.

18 **DEMAND FOR JURY TRIAL**

19 Pursuant to Federal Rule of Civil Procedure 38, plaintiff-relators demand a trial by jury.

20
21 Dated: November 8, 2011

THE JAFFE LAW FIRM

22 MARTHA A. BOERSCH

23
24 By: _____/s/
25 STEPHEN R. JAFFE
26 ATTORNEYS FOR PLAINTIFF-RELATORS
27 SCOTT ROSE, MARY AQUINO, MITCHELL
28 NELSON, AND LUCY STEARNS.